UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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GOLDMAN SACHS & CO.,

Plaintiff,

v. 12 Cv. 4558 (RJS)

GOLDEN EMPIRE SCHOOLS FINANCING AUTHORITY,

Defendant.

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July 18, 2012
4:05 p.m.

Before:

HON. RICHARD J. SULLIVAN

District Judge

APPEARANCES

SULLIVAN & CROMWELL, LLP
Attorneys for Plaintiff
BY: MATTHEW A. SCHWARTZ
DAVID H. BRAFF

FISHMAN HAYGOOD PHELPS WALMSLEY WILLIS & SWANSON, LLP
Attorneys for Defendant
BY: JAMES R. SWANSON

KENNEDY & MADONNA, LLP
Attorneys for Defendant
BY: KEVIN J. MADONNA

(Case called)

THE DEPUTY CLERK: For the plaintiff.

MR. SCHWARTZ: Good afternoon, your Honor. Matthew Schwartz, from Sullivan & Cromwell, for the plaintiff, Goldman Sachs & Co.

THE COURT: Good afternoon.

MR. BRAFF: David Braff, Sullivan & Cromwell.

THE COURT: Mr. Braff, good afternoon.

For the defendants.

MR. SWANSON: Jim Swanson from New Orleans on behalf of the defendants.

THE COURT: Good afternoon, Mr. Swanson.

MR. MADONNA: Good afternoon, your Honor. Kevin Madonna, from Kennedy & Madonna, for defendants.

THE COURT: Mr. Madonna, good afternoon to you.

We are here in connection with the premotion letters -- I guess this is a preliminary injunction motion. I have the letters from the parties that relates to the issues here.

I want to make sure I understand the broker-dealer agreement. There is a broker-dealer agreement which is signed by Goldman and Golden Empire, correct?

MR. SCHWARTZ: That's correct.

THE COURT: And there is a provision of that agreement 5.9, which talks about governing law jurisdiction, waiver of

trial by jury. 5.9 on page 11.

I know the argument of the defendants is that this doesn't really apply to the ARS transactions. That's your argument? I am not sure who is going to carry the ball here.

Mr. Swanson.

MR. SWANSON: I think our argument is really two-fold. The first is that the provision in the broker-dealer agreement is self-referential. It refers to the disputes arising out of the broker-dealer agreement and transactions contemplated thereby or hereof or hereby. And there is a definition in the agreement of what hereby means, and hereby means the auction transactions that are the transactions that are going to occur subsequent to the broker-dealer agreement. Most of what we are complaining about in our statement of claim in the arbitration doesn't relate to that at all. It relates to things that happened during the underwriting of the ARS issuance.

THE COURT: Which is when in relation to this agreement?

MR. SWANSON: I'm sorry?

THE COURT: When is that in relation to this agreement, before or after?

MR. SWANSON: That was before this agreement was executed. The activities we are complaining about led up to the signing of the agreements that consummated this transaction.

THE COURT: Walk me through the chronology.

MR. SWANSON: I don't know off the top of my head the exact dates of the signing of these agreements, but it's very typical that there is a two or three month lead-up period where the transaction is structured, the ARS transaction is structured. It was in that connection that we were working with Goldman Sachs. They were helping us structure the financing. And the structure would include the underwriting of the bonds and then the broker-dealer agreement. And it would be typical -- I don't know how it was done here -- the broker-dealer agreement and the underwriting agreement would be signed at or near the same time.

THE COURT: I am just looking at the agreement and it talks about, whereas, the issuer is issuing $10 million, aggregate principal amount of its 2007 adjustable rate security bonds. I am trying to figure out what this broker-dealer agreement deals with if not these ARSs and the acquisition of them.

MR. SWANSON: The way that the transaction is structured I think is that there are bonds that are sold, and those are sold by Golden Empire to Goldman Sachs pursuant to the underwriting agreement, the bond purchase agreement.

THE COURT: When is that agreement?

MR. SWANSON: That agreement is going to be sometime contemporaneous with the broker-dealer agreement, but it

pertains to a different subject matter. It pertains to the sale of the underlying bonds. What the broker-dealer agreement covers is the actions that Goldman Sachs is going to take as broker-dealer in connection with the auctions that occur after the issuance. So there are periodic auctions and that agreement governs what Goldman Sachs is supposed to do for us in connection with those auctions. I don't know if you follow that, your Honor.

THE COURT: I follow that. I am just looking to see that in the language of the broker-dealer agreement. Is there another agreement that deals with the bonds themselves?

MR. SWANSON: The bond purchase agreement.

THE COURT: Do I have that one?

MR. SWANSON: I don't know if you have it. I would think it would be attached to the letters. I do not know whether that was provided to you. Certainly, in connection with the motion we would attach and append that, yes.

THE COURT: It's an appendix to --

MR. SCHWARTZ: To the complaint, your Honor.

THE COURT: I am going to print that out. That's probably where we ought to start, what does the broker-dealer agreement cover and what does it not cover? Your view is it doesn't cover the acquisition of the bonds themselves, right?

MR. SWANSON: The original issuance and acquisition of the bonds, it does not cover that. It covers what is going to

happen with respect to the periodic auctions of the auction rate securities after they are issued.

THE COURT: Mr. Schwartz, you agree or disagree with that?

MR. SCHWARTZ: We disagree with that. I think for a few reasons, it's very hard to separate out the issuance of the bond purchase agreement from the terms of the broker-dealer agreement.

First, as I think we pointed out in our letter, it is a very broad merger clause in the broker-dealer agreement. It says the broker-dealer agreement and the other agreements and instruments executed and delivered in connection with the issuance of the ARS contain the entire agreement between the parties related to the subject matter hereof.

THE COURT: But 5.9 just says the broker-dealer agreement shall be governed according to the laws of New York. The other document language is not in 5.9, is it?

MR. SCHWARTZ: That's right. But in terms of looking at these agreements separately or together, it's very clear from the language of the agreement that they are contemplated as a contemporaneous transaction. As counsel said, these were executed contemporaneously and the entire transaction is obviously one where Goldman Sachs purchases the bonds from the issuer and then acts as the broker-dealer to the issuer.

THE COURT: But if the broker-dealer agreement has a

clause that talks about governing law and it only refers to the broker-dealer agreement, and there is a separate agreement relating to the ARSs -- do I call them that?

MR. SCHWARTZ: That's correct.

THE COURT: The plural of ARS.

-- themselves, and that document doesn't have a governing law jurisdiction and waiver of trial by jury section, doesn't that suggest that it's not covered by the broker-dealer agreement?

MR. SCHWARTZ: We don't think so, your Honor. We think under the New York case law that you have to look at the contemporaneous executed agreements, you look at them holistically. That's the first thing.

The second thing, as counsel said, he said most of our claims arise out of the bond purchase agreement. That clearly suggests, and we think, frankly, most of this case relates to the actions of Goldman Sachs' broker-dealer, but that shows that counsel is conceding that at least a large part of his claims in front of FINRA are arising out of actions that are governed by the broker-dealer agreement. And we really don't see how, with an exclusive forum selection clause saying that any claims arising out of the broker-dealer agreement, which counsel is effectively conceding are in front of FINRA right now, how those can proceed in front of FINRA as opposed to this court with a clear clause like that?

THE COURT: Why not have an express reference to FINRA and the fact that the parties have agreed that they are not going to have arbitration before FINRA? It could be that, right? Sometimes agreements say that.

MR. SCHWARTZ: That could be done, your Honor, but we don't think that's the standard under the Second Circuit case law, under the cases decided by districts in this circuit. We have had cases, such as the *Applied Energetics* case, the *Anderson* case, and the *Biremis* case, all dealing with exclusive forum selection clauses, that seem provide, as here, that any actions arising from those agreements need to be brought in federal court and not explicitly stating that they are not going to be done in front of FINRA.

So the standard has not been an ironclad statement that we are not going to do it in front of FINRA, we are going to do it in federal court, but simply and logically, if you say you're going to bring something in front of federal court, it means that you are not going to be bringing it in front of FINRA.

THE COURT: *Applied Energetics* and the *Bank of Julius* case have different language than here so each requires a certain parsing of the language.

It just is surprising to me that an entity that is sort of a member of FINRA, has agreed they are going to be bound by FINRA rules, including arbitration requirements as a

FINRA member, can be so easily overridden and nobody thinks they need to make any reference to the FINRA rules.

MR. SCHWARTZ: Your Honor, I grant that belt and suspenders were not used in this exclusive forum selection clause, but again, the cases that have ruled on this -- and I can go through the actual clauses that were at issue both in the cases that we cited in our letter and that the defendants cited in their letter. The cases that we rely on are very clear, both from the Second Circuit and from the Eastern District, with clauses and postures almost identical to here, that if you say that the actions arising out of the agreements are exclusively to be brought in federal court, that is sufficient to make crystal-clear to everybody that they are not allowed to be brought in front of FINRA.

If your Honor would like, I can go through a couple of those cases for you.

THE COURT: I have seen the language. There is different language. *Applied Energetics* talks about adjudicated, and the Second Circuit made a big deal about that because that is an unmistakable reference to judicial action, which distinguished it from the *Bank Julius* case which had squishier language.

I don't know whether that's persuasive, but the language here is different altogether. Here adjudicated isn't used at all. It just talks about all actions and proceedings

arising out of this broker-dealer agreement, or any of the transactions contemplated hereby shall be brought in the U.S. district court.

MR. SCHWARTZ: That's correct. Obviously, this court does not do FINRA arbitrations, it only does litigations. So I don't see how somebody can read this provision as saying that claims arising out of the broker-dealer agreements could be brought in any forum other than this court. Certainly, whether the word adjudicated is there or not, it's crystal-clear that FINRA arbitrations cannot be brought before your Honor.

THE COURT: Mr. Swanson, what did your client think this meant when they signed it?

MR. SWANSON: I believe that the language in that agreement says actions and proceedings. So it doesn't reference arbitration in any way, shape or form. So when my client was executing that document, they had absolutely no idea that they would be waiving their right to arbitrate.

THE COURT: What would be the reasonable construction of this section that would not include the FINRA dispute that's at issue here?

MR. SWANSON: I think the reasonable construction of that provision would be that it applies to the broker-dealer agreement. And if you look, it says hereof at the end of that clause you read. Hereof is a defined term in the broker-dealer agreement that means the broker-dealer agreement, not all the

other agreements. I think it's page 2 of the broker-dealer agreement you will see there is a defined term that says that.

So we thought that we were --

THE COURT: What it says is, "The words herein, hereof, hereto and hereunder, and any other words of similar import, refer to this broker-dealer agreement as a whole and not to any particular section or other subdivisions."

MR. SWANSON: It didn't refer to the underwriting process and the bond purchase agreement is my point there. And the second thing that we --

THE COURT: What is an example of something that would be covered by this exception and a reasonable party signing this agreement would think that they were getting without waiving their FINRA dispute rights over disputes like this one? What sort of an action or proceeding arising out of the broker-dealer agreement would be contemplated by this?

MR. SWANSON: Anything that arose out of the broker-dealer agreement, such as there is a question of how much the fee was that we owed, or whether they had undertaken their responsibilities to locate bidders and submit bids, or if they received bids and did not properly submit those bids to the auction agent. Those would all be covered by that clause potentially.

Depending, of course, upon the meaning of actions and proceedings. And, your Honor, I think we are going to develop

in the briefing an argument that under the New York law, and under the definitions that are contained in New York statutes, that actions and proceedings do not mean arbitration. That is not something we developed in our letter, but we do plan to offer that argument in connection with the briefing of the injunction. That's something we have been developing in the last couple of days. And I think from the look of it, when I was looking at it earlier today, it looked to be a fairly strong argument in its own right.

So we would say, at best, your Honor could say a dispute that arises out of the broker-dealer agreement or the transactions contemplated therein would have to be litigated. But the cases say that when you look at this, you're looking through the lens of -- the favored lens of arbitration, and if there is any question, or if there is any ambiguity, or if there is any uncertainty, you would have to arbitrate. This language is not clear and unequivocal because it contains the words actions and proceedings and because it's not as broad to cover all the agreements, it covers the broker-dealer agreements.

So, at worst, I would suggest, your Honor, that you could enjoin Golden Empire from litigating disputes that arise under the broker-dealer agreement, but not the disputes that relate to the underwriting of these bonds, because those were governed by the bond purchase agreement which has no such forum

provision in it.

Those are the arguments that we plan to develop in the briefing in more detail.

THE COURT: My problem is I am not sure I fully see the difference between the two terms that you just described, what is under 5.9(a) and what is not under 5.9(a).

We have got a July 11 bond purchase contract and that has a governing law section, but it doesn't have a choice of forum section. It doesn't make any reference to arbitration either, right?

MR. SWANSON: That's correct.

THE COURT: Then we have got a broker-dealer agreement, which does it make any specific reference to this July 11 document? I don't think so, right?

MR. SWANSON: I think it would be typical that the whereas clause would refer to the transaction documents for the entire transaction in the broker-dealer agreement.

THE COURT: There is a whereas clause that refers to the issuance of $10 million in ARSs, and then it also talks about an indenture of trust dated July 1, but I don't think it makes any reference to this July 11 agreement. Am I wrong about that?

MR. SCHWARTZ: The merger clause is very clear that the broker-dealer agreement and the other agreements and instruments executed and delivered in connection with the

issuance of the ARS contain the entire agreement.

THE COURT: Where are you referring to?

MR. SCHWARTZ: That's in the merger clause.

THE COURT: What section?

MR. SCHWARTZ: I apologize. Section 5.4, your Honor, on page 13.

THE COURT: On page 11, right?

MR. SCHWARTZ: It guess it depends on what year you're looking at. Section 5.4. I think it's the same section throughout.

THE COURT: So the broker-dealer agreement and the other agreements and instruments executed and delivered in connection with the issuance of the ARSs contain the entire agreement between the parties relating to the subject matter hereof. There are no other representations, endorsements, promises, agreements or understandings between the parties relating to the subject matter hereof. How does that lead to the conclusion that 5.9(a) basically carries over a governing law and jurisdiction provision that would apply into all of these agreements that don't have that?

MR. SCHWARTZ: I think there are two answers to that, your Honor. The first is, as we said before, you can even put that question aside and simply look at the claims that they brought here and see that their claims are based on both Goldman Sachs' role as the underwriter and as the

broker-dealer, and I think counsel has to concede that a tremendous portion of their claims has to do with what Goldman Sachs did in terms of submitting covered bids as a broker-dealer.

THE COURT: Do you agree with that, Mr. Swanson?

MR. SWANSON: I agree that there are some claims that do relate to that.

THE COURT: You're prepared to back off of those in the arbitration?

MR. SWANSON: Yes.

THE COURT: I guess it's worth knowing which ones those are at some point, but keeping going.

MR. SCHWARTZ: We would be interested in seeing that because I think their claims are so intertwined with the broker-dealer agreement that it would be pretty impossible for them to do that, but we will see what counsel suggests.

As to the first part, which is the question that you asked, to directly answer that, we think that under New York law, when you look at a series of agreements that are executed contemporaneously concerning the same transaction, and you have a merger agreement there, that it's pretty clear that you are supposed to look at them holistically.

Here what we have is an underwriter agreement that has no forum selection clause, but a broker-dealer agreement that has a very clear forum selection clause. Regardless of whether

it says actions and proceedings, any actions and proceedings need to be brought before this court, and again, this court does not do FINRA arbitration, your Honor. So we think if you look holistically at these documents and you look at their claims, it's very clear that those claims need to be brought here and cannot be brought in FINRA.

THE COURT: The presumption sort of runs in favor of arbitration.

MR. SCHWARTZ: I don't agree with that. I think the presumption runs in favor of the breadth of arbitration once it's been established that arbitration has been agreed to. But there is no presumption in favor of arbitration and the court needs to look at the documents to see whether or not arbitration even has been agreed to in the first place without using a presumption, and that's obviously something we would develop in our briefs.

THE COURT: What is going on with the arbitration now?

MR. SCHWARTZ: Well, the arbitration has been stayed, as we indicated in a footnote in our letter, and the agreement between the parties is that it would be stayed pending this Court's order on our motion for a preliminary injunction. After that there is no agreement as to what would happen in the arbitration.

THE COURT: They filed the arbitration in February, right?

MR. SCHWARTZ: That's correct.

THE COURT: And you didn't file this action until late June, right?

MR. SCHWARTZ: That's correct, your Honor.

THE COURT: June 11. So four months. What was going on in the four-month period?

MR. SCHWARTZ: There was problems with FINRA serving us to begin with, and then in the interim, the only thing that has been done is that we have filed a placeholder answer with FINRA stating -- and I think this was attached to the complaint -- stating, one, that we were going to be moving for a preliminary injunction in front of this court, but, two, to preserve our rights, we deny all the allegations in their statement of claims for these few basic reasons.

So we haven't done any discovery. I don't think there has been a panel selected in that particular case. It's really just been the very bare bones basic stuff that Goldman Sachs needed to do in order to preserve its rights in case your Honor rules against us in the preliminary injunction.

THE COURT: You agree with that, Mr. Swanson?

MR. SWANSON: I do.

THE COURT: I think it's an interesting issue. I have to say it's difficult for me to get my head around what exactly is an action and proceeding arising out of this broker-dealer agreement or any of the transactions contemplated hereby. And

I guess I want to see that developed with respect to what are the claims in the FINRA arbitration and how each of them fits or doesn't fit. As Mr. Swanson seems to be conceding, some of them don't fit or some of them do fit under this. So I want to figure out which are the close calls and which are the ones you agree do arise out of the broker-dealer agreement and therefore would not be subject to the FINRA arbitration. It sounds like you want to find that out too, Mr. Schwartz.

MR. SCHWARTZ: I would be very interested to see how they can disentangle their claims. I don't think it's possible, but we will take a look.

THE COURT: Depending on how the disentangling happens, it may make this more or less problematic to you, right? It couldn't be more. I guess it could only be less.

MR. SCHWARTZ: I think that's right, but I am highly skeptical that they will be able to do that.

THE COURT: Mr. Swanson, have you thought that through at this point?

MR. SWANSON: Not entirely, no, your Honor. I think the threshold issue is whether this clause is a waiver of our right to arbitrate, and this is where I disagree with what Mr. Schwartz just said. There is a strong presumption against finding a waiver of arbitration unless it is clear and explicit, and I don't believe that this clause as a threshold issue meets that.

THE COURT: I think the *Bank Julius* case does say that. I think the Second Circuit then seemed to backtrack a bit with the later case *Applied Energetics* and some others. Three decades or so passed in the interim, right?

MR. SCHWARTZ: *Bank Julius* also had a nonexclusive forum selection clause. The word was "may," not "shall." So it's a very, very different case. It's very distinguishable as we will go through in our brief.

THE COURT: The court in *Bank Julius* found a strong presumption resolving doubts about the scope of arbitrable issues in favor of arbitrability. Do you agree with that?

MR. SCHWARTZ: That is what they found. Again, if you look to more recent cases, in *Applied Energetics* and *Anderson*, the Second Circuit is very clear that the type of exclusive forum selection causes that we have in the broker-dealer agreement -- again, let's put aside the issue about whether the broker-dealer agreement applies to all the claims here -- that the type of exclusive forum selection clauses that we have in the broker-dealer agreement are clearly sufficient to override the sort of default rule that you have that FINRA customer arguments are resolvable in front of FINRA arbitration panels.

MR. SWANSON: I just would say that I don't agree with that. The language in their cases that he is citing is disputes. They say any dispute. This language is actions or proceedings. As you pointed out, it's all about parsing the

language of this agreement. And again, we will develop that in our briefing as we go forward.

THE COURT: I think the language and the gist of the Second Circuit case law is that a forum selection clause has to be pretty explicit in precluding an earlier agreement to arbitrate. I think they use the word positive assurance that the dispute is not governed by the arbitration agreement.

I am not sure that this is as explicit or as clear as it could have been or should have been if it was intended to say under no circumstances are we ever going to FINRA with disputes.

That's really your position, right, Mr. Schwartz? There is virtually no dispute between these parties that is going to be the subject of FINRA arbitration.

MR. SCHWARTZ: That's correct. And I think our interpretation is very much in keeping with the *Anderson*, *Applied Energetics* and the *Biremis* case, none of which said explicitly that we are never going to be arbitrating in front of FINRA.

THE COURT: It might be worth advising Goldman in the future it's a lot cheaper to just put the language in contracts rather than lawyers spend half a day in court and for judges and clerks to try and parse through the language. Free advice.

MR. SCHWARTZ: As your Honor knows, you always learn things from litigation. Otherwise we wouldn't be here if

everything were belt and suspenders. But we do think that under the case law that this is pretty clear.

And just in response to Mr. Swanson's statement that this says transactions and proceedings, again, I will reiterate that --

THE COURT: Actions and proceedings.

MR. SCHWARTZ: Unless the court wants to change itself and start to hold FINRA arbitrations, you cannot bring FINRA arbitrations in front of the Southern District of New York, and it's very clear that all actions and proceedings shall be brought in front of the Southern District of New York.

THE COURT: So the key phrase is, arising out of this broker-dealer agreement or any of the transactions contemplated hereby. Where I am still fuzzy, and maybe it's just because I don't understand these transactions and these arrangements as well as you folks do, is what that means and what it doesn't mean. If it means, basically, any dispute between these parties related to these bonds, then it seems to me there is an easy way to say that. I think it will be easier than what has been said here. It seems odd to me that just a few days before this agreement was signed, the broker-dealer agreement, you have got a bond purchase agreement that doesn't say anything of the kind and just makes a reference that says that the bond purchase contract shall be governed by the laws of the state.

There certainly is some confusion it seems to me as to

what exactly the parties want when they have got documents floating around over a one- or two-week period that have different governing law sections, or each document has a governing law section, but only one has an exclusive jurisdiction section.

MR. SCHWARTZ: With hope, our briefing can make it clear to you that the claims that they have brought in their statement of claims are completely intertwined with the broker-dealer agreement, one. So you wouldn't even have to reach the issue about whether or not the broker-dealer agreement's exclusive forum selection clause applies to the underwriting agreement as well. You can just say there is an exclusive forum selection clause here. These claims arise from the broker-dealer agreement. Regardless of whether these claims arise from other agreements as well, they clearly arise from the broker-dealer agreement, and we will have a preliminary injunction. Or, in the alternative, that our arguments, looking at the New York case law and looking at the way other cases have construed similar situations where you have more than one agreement, and one agreement has a forum selection clause and the other one doesn't, those cases look at it holistically, and we hope that case law can be helpful to your Honor as well.

THE COURT: Obviously, we are just now going off of a letter so this is not full briefing. What did you have in mind

for a briefing schedule? Did you folks talk about that?

MR. SCHWARTZ: We haven't. We would be prepared to move fairly quickly. I would have said that we had been prepared to move within the next day or so before this conference, but I think we would like to take some of your Honor's questions and comments into account and work on our briefs a little bit, but I think that we could be ready in the next week to two weeks to file something.

THE COURT: That's fine with me. Nothing is going to happen until we resolve this, right?

MR. SCHWARTZ: I think that's correct.

THE COURT: Mr. Swanson, what were you thinking?

MR. SWANSON: I think we would be in a position to file our brief, if he is going to file next week, I think we could file a week later.

THE COURT: He said a week or two. Are you fishing for two? It's all the same to me. I am going to take a couple of weeks in the beginning of August. I will be working, but you folks may also want to take some time.

MR. SCHWARTZ: If it's all right, maybe what we should do is confer with each other and submit a letter to the Court or a proposed scheduling order to the Court.

THE COURT: That's fine with me. I assume that the normal size brief will be more than sufficient to nail all this down. So let's presume that. That's fine. You want to get me

a letter by Friday that tells me the proposed schedule? And then once I have that, I will either agree or not, and then I will set a date for oral argument as well.

Anything else we should cover today?

MR. SCHWARTZ: I don't think so.

THE COURT: All right. I look forward to being educated on this transaction or these transactions and ARSs and everything else.

Thanks a lot.

(Adjourned)